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 **SUMMARY OF ACCOUNTING FOR CHANGING PRICES**

The prices of most goods and services fluctuate, often times increasing. Using an information on statement of financial position at their historical cost during a period of price change can make the statement of financial position irrelevant. Hence, the need for accounting for changing prices also termed Inflation accounting. When the prices of goods and services in an economy increases in general, it is said that inflation has occurred and inflation is measured by determining the current price of goods and services and comparing the price of the goods and services at the current price with the price of the same goods and services at an earlier time. This general inflation rate also reflects the decrease in the purchasing power of the company.

During a period of inflation, assets reported on statement of financial position at historical costs are understated which results in understated expenses which in turn results in overstated net income and retained earnings. Ignoring the recent changes in price of assets has several impacts such as ; having negative impacts on a company’s ability to borrow because of understated asset values ( collateral), more taxes being paid to the government than would otherwise be paid also leading stakeholders to demand a higher level of dividend that would otherwise be expected because of overstated income results, companies being exposed to different rates of inflation which can distort companies across companies due to the difference in the understatement of assets and overstatement of income.

Also, during a period of inflation, historical cost accounting ignores the purchasing power gains and losses that arise from holding monetary assets in addition to ignoring changes in values of non- monetary assets. In a sense that, cash and receivables at hand result in purchasing power loss while holding payables result in purchasing power gain.

There have been two major methods/solutions developed to deal with the distortions caused by historical cost accounting in a period of changing price. The first being: Account for changes in general price level tagged (GPLAHC) or alternatively; account for specific price changes by updating the values of assets from historical cost to the current cost to replace those assets, this is known as Current Replacement Cost (CPC) or Current Cost (CC). In addition, GPP accounting requires purchasing power gains and losses to be included in the determination of net income. The application of each of the three methods of asset valuation result in a different amount of net income.

The economic definition of income is that it is the amount that can be distributed to owners after making sure that the company is as well off at the end of the year as it has at the beginning. Thus, historical cost income is the amount that can be distributed to owners while maintaining the “normal” amount of contributed capital at the beginning of the year.

In General- Purchasing Power (GPP) accounting, non-monetary assets and liabilities, stockholders, equity, and all income statement items are restated from the GPI at the transaction date to the GPI at the end of the current period. In Current Cost (CC) accounting, historical costs of non-monetary assets are replaced with current replacement costs and expenses are based on their current costs. Current Cost accounting must be applied because the prices of specific goods and services purchased by an individual company do not necessarily increase at the rate 0f average inflation.